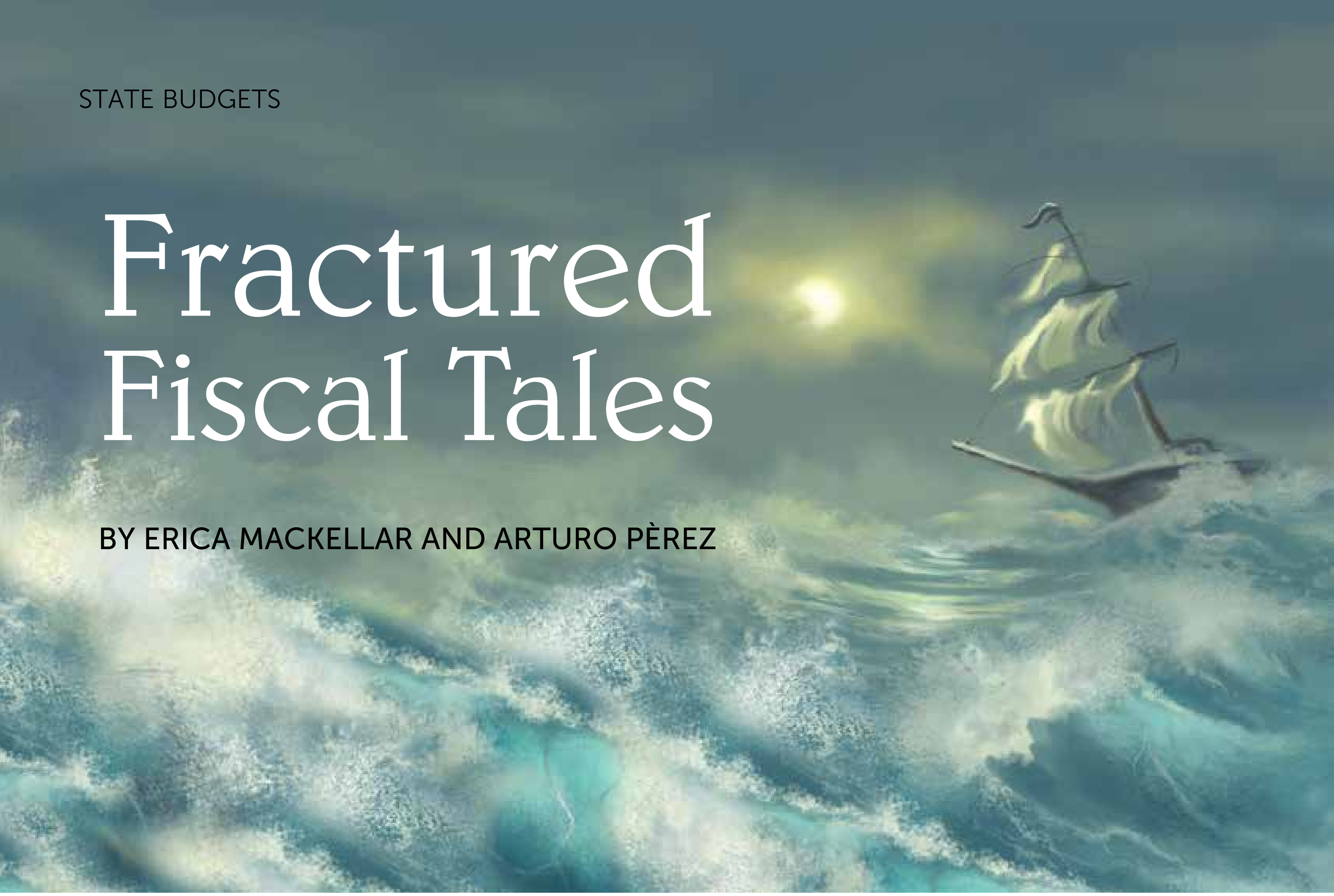

Fractured Fiscal Tales

BY ERICA MACKELLAR AND ARTURO PÈREZ

Although most states have avoided budget shortfalls, others face surprising new spending pressures.

Since the end of the Great Recession, despite changes in policies and politics, states have rolled along the fiscal highway at a slow but steady pace. Revenue growth has been modest—enough to maintain state spending, but not robust enough to sustain any broad new initiatives. But now, as fiscal year 2016 begins, some states are encountering more speed bumps along the road to recovery. How drastic are conditions changing? It varies by state.

Surprise, Surprise!

In a development that surprised most budget observers, more than a dozen states had to close shortfalls as they prepared to enact FY 2016 budgets. Alaska legislators faced one of the largest, at more than $3 billion for the new fiscal year. That's a big chunk of a budget that in FY 2013 was just over $7.5 billion.

The state relies on revenues from oil and gas for about 80 percent of its general fund, so Alaska's finances were hit particularly hard when the price of a barrel of oil dropped from $115 in mid-2014 to around $45 at the start of this year. It took a special legislative session for lawmakers and the governor to hammer out a spending plan for FY 2016 before the July 1 deadline.

Louisiana also was hurt by falling oil prices. The drop in oil revenue was a major factor in a $1.6 billion projected budget shortfall for FY 2016, though other structural and economic challenges, including a weaker-than-expected personal income tax performance, were also to blame.

To bridge the budget gap, the Legislature ultimately relied on a mix of tax increases and tax credit reductions. The budget-balancing package included a $180 million cap on the state's popular film tax credit program and a 50-cent-per-package increase in cigarette taxes.

Lawmakers in Kansas had a difficult time agreeing on a spending plan for the new fiscal year as state coffers were projected to be short by more than $400 million in the new budget year. The legislators' debate over how best to close the gap made the 2015 session the longest in state history.

Officials in Kansas pointed to several rea-

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sons for the shortage, including weaker-than-projected economic growth coupled with lower severance tax collections and a drop in corporate income taxes. The Legislature extended its regular session into early June and eventually passed a balanced budget that included an increase in the statewide sales tax from 6.15 percent to 6.5 percent and a hike in the cigarette excise tax rate from 50 cents per package to $1.29. A shift toward sales taxes and away from income taxes was seen in other states too, as lawmakers looked for ways to fill the gaps.

Working Overtime

Three states facing budget challenges had yet to complete their budget sessions as this issue went to press at the end of June.

In Illinois, an assortment of economic issues, along with public pension liabilities and expiring temporary taxes, contributed to a $6 billion deficit at the start of FY 2016. The General Assembly and the governor spent much of the 2015 session battling over how to close the gap. Among the unresolved issues were a proposal from the new governor to freeze property taxes and a fix for the nation's worst-funded public pension system.

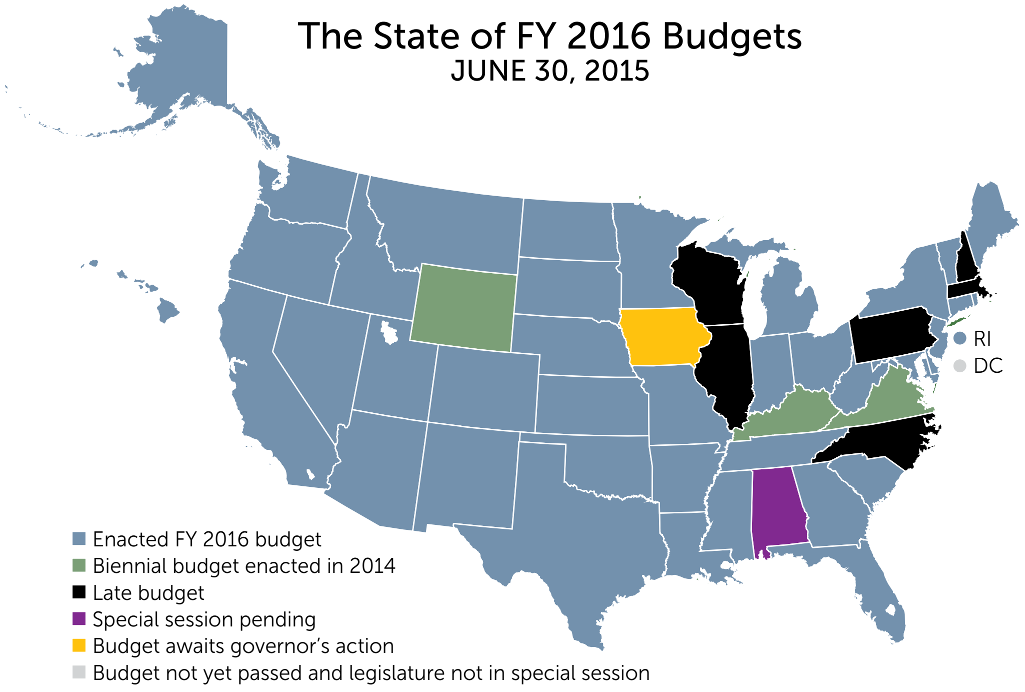
In Pennsylvania, the legislature and governor were sparring over the best way to cover a $1.2 billion budget shortage. Tax increases, pension reforms and changes to the state-run liquor store system had all been proposed as possible solutions.

Connecticut lawmakers entered into their budget negotiations facing a $1.4 billion shortfall. By the beginning of June, the legislature had agreed on a plan to balance the budget, but after the business community expressed concerns over corporate income tax increases, the governor and lawmakers reopened negotiations as the start of the new fiscal year approached.

Smooth Sailing for Some

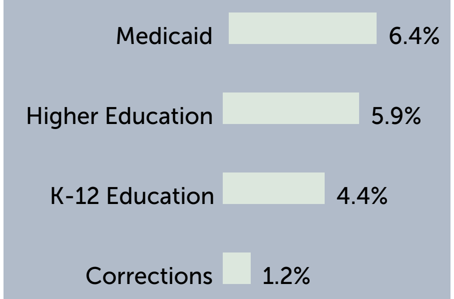
The underlying reasons for state budget gaps vary greatly, and not all spell trouble. Most states have recovered from the harshest effects of the recession, with a few reporting "strong" fiscal conditions. And despite the general lack of revenues, a handful of state legislatures managed to enact balanced budgets for FY 2016 with plenty of time to spare.

The Arizona Legislature completed its work on the state's spending plan and adjourned with the shortest legislative session in nearly half a century.



Source: NCSL

Percent Change in General Fund Appropriations for Major Budget Categories in FY 2015 (projected)



Source: NCSL survey of state legislative fiscal offices, summer 2014

Even California—a state that has struggled significantly in the recent past to adopt a budget on time—made the deadline. California lawmakers sent a spending plan to the governor before the June 15 budget deadline, after which they would have had to forfeit their pay.

In Colorado and Utah, lawmakers were in the enviable position of having to decide what to do with surplus tax revenue.

Tough Choices Remain

In the rest of the states, however, the underlying reasons for fiscal wariness vary from lower-than-expected oil revenue, to unusually high health care expenses, with many others in between.

In several states, spending pressures are threatening to outpace revenue growth. Increasing health care and education expenses continue to consume an ever-increasing share of state revenues.

At the same time, revenue growth has been notably slow—averaging between 1 and 3 percent since the recession ended in 2009, compared with 5 percent or more before the recession.

The heightened feeling of fiscal uncertainty leaves lawmakers dodging potholes as they decide how best to allocate limited revenues.

Fortunately, many have driven this road before.